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Research Update:

Swiss Canton Basel-Country 'AAA/A-1+' Ratings Affirmed On Wealthy Economy And Positive Liquidity; Outlook Negative

Primary Credit Analyst:

Sabine Daehn, Frankfurt (49) 69-33-999-244; sabine.daehn@standardandpoors.com

Secondary Contact:

Thomas F Fischinger, Frankfurt (49) 69-33-999-243; thomas.fischinger@standardandpoors.com

Research Contributor:

Ludwig Heinz, Frankfurt (49) 69-33-999-246; ludwig.heinz@standardandpoors.com

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Overview

- The canton operates under a predictable and supportive institutional framework, has a wealthy economy, and very positive liquidity position.
- In our opinion, the Swiss Canton of Basel-Country could face deteriorating budgetary performance, which could also signal weaker effectiveness of the canton's financial management.
- We are affirming our ratings on the Canton of Basel-Country at 'AAA/A-1+'.
- The negative outlook continues to reflect our view that there is a one-in-three likelihood that Basel-Country will not successfully implement its savings measures over the next two years.

Rating Action

On July 19, 2013, Standard & Poor's Ratings Services affirmed its 'AAA/A-1+' long- and short-term issuer credit ratings on the Canton of Basel-Country. The outlook remains negative.

Rationale

The ratings on Basel-Country benefit from the predictable and supportive institutional framework for Swiss cantons and the canton's very strong economy. The canton's liquidity position, although weakening, remains very positive, in our view.

We regard the canton's budgetary performance as a weakness within this rating category, even if we exclude the one-time expense for the pension fund re-capitalization plan. This re-capitalization plan also considerably increases Basel-Country's debt burden, but it remains moderate in an international comparison. Considering the canton's strong budgetary flexibility, consolidation appears achievable over the next 18-24 months and currently seems on track despite the change in the management team. However, we could change our current view of the management as very strong if the proposed consolidation measures fail to achieve budgetary improvements. Furthermore, the canton has moderate contingent liabilities.

The ratings on Basel-Country reflect the canton's dynamic economy. GDP per capita stands at about 145% of the EU-27 (excluding Croatia) and almost on par with the national average, making it one of the wealthiest regions in Western

Europe. This also means that Basel-Country is a net payer in the Swiss fiscal equalization system, with a resource index of 101.6 in 2014, after 99.5 in 2013 (100 marks the national average for this index, which is an indicator of fiscal resources among Swiss cantons.) However, the budgetary impact for the canton is limited, as the total volume of contributions is below 1% of operating expenditures. Overall, we view the institutional framework for Swiss cantons as mature and well-balanced.

Despite the robust economy and very low unemployment in Basel-Country, the canton still faces budgetary challenges due to reduced tax revenue growth after the the last tax reform became effective and increased costs, particularly with respect to hospital financing. In our base-case assumption, we have included our belief that the management will implement savings measures as proposed under its financial plan 2013-2016, and the re-capitalization of the pension fund as a one-off expense affecting budgetary performance as of year-end 2014. The canton theoretically has high budgetary flexibility, highlighted by about 80% modifiable revenues. However, due to political constraints, we believe that the canton is unlikely to increase taxes to counteract a structural deterioration of its financial position. In our view, the canton would adjust spending instead. The canton's current consolidation plan already depicts this standpoint, proposing savings measures and expenditure cuts, such as a tightening grip on personnel costs. While the cantonal management team has undergone a further change with a new finance minister being elected, we believe the canton will continue to apply very prudent management policies, focusing on structurally balancing its accounts, in line with the canton's conservative financial guidelines. Additionally, the canton is currently reviewing its tasks and responsibilities to evaluate additional consolidation potential.

We project the canton's operating balance as a percentage of adjusted operating revenues to remain positive, on average, in our base-case scenario. Several investment projects--which affect Basel-Country's capital expenditures profile from year to year differently--have caused some volatility in the balance after capital accounts as a percentage of total adjusted revenues, as does the re-capitalization of the pension fund. Yet, the distinct format of the re-capitalization is still to be determined and up for popular vote in September 2013. Disregarding there-capitalization as a one-time item, we also continue to expect the deficit after capital accounts on average to remain above 10% of total adjusted revenues over the coming years.

With the full re-capitalization, unfunded pension liabilities are set to decline sharply and no longer change our view of the debt burden. According to our assumptions, we expect debt to remain below 120% of consolidated operating revenues, qualifying the debt level as moderate by international standards. However, it is on the higher end compared with national peers. Due to positive market effects on the coverage ratio within the pension fund, the impact on Basel-Country's debt burden is slightly lower than we previously anticipated.

Lastly, we factor into our assessment the canton's moderate contingent liabilities, of which the largest component is the cantonal ownership of 74%

of Basellandschaftliche Kantonalbank. Basel-Country provides a statutory guarantee for its liabilities. Given the bank's stand-alone credit profile of 'aa-', we currently regard the likelihood of the guarantee being called as low.

Liquidity

We view Basel-Country's current liquidity position as very positive, including access to external funding, even though the volume of its liquid assets has reduced sharply over the past 18 months. At year-end 2012, the volume of liquid assets stood at Swiss franc (CHF) 154 million, and we note the canton's contracted bank line of CHF50 million. Overall, the canton has on average about 100% of free cash, liquid assets and committed bank lines available to cover the next 12 months' debt service, already including the CHF150 million maturity in 2014.

We regard the canton's access to external liquidity as strong, and we factor this into our very positive liquidity assessment. This is in line with our favorable view of Switzerland's banking sector, as described in "Banking Industry Country Risk Assessment: Switzerland," published May 15, 2013. Furthermore, Basel-Country's close relationship with its cantonal bank, Basellandschaftliche Kantonalbank is an additional positive factor.

Outlook

The negative outlook continues to reflect our view that there is a one-in-three likelihood that we may see deviations from Basel-Country's consolidation plan with significant financial effects or delays over the next 18 months. This would result not only in a further deterioration of its budgetary performance, potentially even leading to operating deficits, but could also lead to a weakening of our assessment of the effectiveness of the canton's financial management. Furthermore, it might weigh on Basel-Country's currently moderate debt level to a value above 120% of consolidated operating revenues.

We might revise the outlook to stable if the canton's management succeeds in reversing the trend of budgetary deterioration and returns to a structurally balanced budget in the next 18-24 months, with a solid positive operating performance.

Under our base-case scenario, we continue to believe that Basel-Country can limit further debt increases beyond currently projected levels and should retain a sufficient liquidity position at a volume to cover upcoming debt service.

Note: A supplementary analysis is available in German. Please send an e-mail to PublicFinanceEurope@standardandpoors.com to request a copy.

Published Rating Factor Scores

Table 1

Canton of Basel-Country Summary Of Published Rating Factor Scores*	
Rating factor	Score
Institutional framework	Predictable and supportive
Financial management	Very positive
Liquidity	Very Positive
Overriding factors	N/A

*Standard & Poor's ratings on local and regional governments are based on, among other things, a scoring system that covers eight main rating factors, as further explained in our criteria (see below). We publish our scores for the three rating factors above.

Key Statistics

Table 2

Canton of Basel-Country Economic Statistics					
	--Fiscal year end Dec. 31--				
	2009	2010	2011	2012	2013f
Population	274,673	275,756	277,042	277,973	279,919
Population growth (%)	1.6	0.4	0.5	0.3	0.7
GDP per capita (in CHF)	67,231.0	69,603.0	70,358.4	70,375.6	71,027.0
Unemployment rate (%)	3.3	3.3	2.7	2.7	N/A

N/A--Not available. Sources: Swiss Federal Statistical Office and Standard & Poor's.

Table 3

Canton of Basel-Country Financial Statistics										
	--Fiscal year end Dec. 31--									
	--Actual--				--Base case*--			--Downside\$--		
(Mil. CHF)	2009	2010	2011	2012	2013	2014	2015	2013	2014	2015
Operating revenues	2,561.5	2,653.7	2,726.4	2,335.3	2,321.3	2,409.0	2,470.0	2,474.8	2,557.0	2,610.0
Operating expenditures	2,479.5	2,604.0	2,666.2	2,295.4	2,336.6	2,389.0	2,400.0	2,524.6	2,661.0	2,612.0
Operating balance	82.0	49.7	60.2	39.9	(15.3)	20.0	70.0	(49.8)	(104.0)	(2.0)
Operating balance (% of operating revenues)	3.2	1.9	2.2	1.7	(0.7)	0.8	2.8	(2.0)	(4.1)	(0.1)
Capital revenues	88.8	81.0	72.0	75.1	60.9	69.0	60.0	60.9	69.0	60.0
Capital expenditures (capex)	209.2	197.9	420.0	186.4	303.4	1,007.1	257.9	361.4	1,037.1	287.9
Balance after capital accounts	(38.4)	(67.2)	(287.8)	(71.4)	(257.8)	(918.1)	(127.9)	(350.3)	(1,072.1)	(229.9)
Balance after capital accounts (% of total revenues)	(1.4)	(2.5)	(10.3)	(3.0)	(10.8)	(37.1)	(5.1)	(13.8)	(40.8)	(8.6)
Debt repaid	100.0	200.0	200.0	100.0	180.0	150.0	100.0	180.0	150.0	100.0
Balance after debt repayment and onlending	(138.4)	(267.2)	(487.8)	(171.4)	(437.8)	(1,068.1)	(227.9)	(530.3)	(1,222.1)	(329.9)

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Balance after debt repayment and onlending (% of total revenues)	(5.2)	(9.8)	(17.4)	(7.1)	(18.4)	(43.1)	(9.0)	(20.9)	(46.5)	(12.4)
Gross borrowings	0.0	200.0	435.4	140.2	250.0	1,070.0	230.0	340.0	1,220.0	330.0
Balance after borrowings	(138.4)	(67.2)	(52.4)	(31.2)	(187.8)	1.9	2.1	(190.3)	(2.1)	0.1
Operating revenue growth (%)	(11.3)	3.6	2.7	(14.3)	(0.6)	3.8	2.5	N.M.	N.M.	N.M.
Operating expenditure growth (%)	2.8	5.0	2.4	(13.9)	1.8	2.2	0.5	N.M.	N.M.	N.M.
Modifiable revenues (% of operating revenues)	80.4	80.6	80.3	80.7	80.8	83.4	83.8	N.M.	N.M.	N.M.
Capex(% of total expenditures)	7.8	7.1	13.6	7.5	11.5	29.7	9.7	12.5	28.0	9.9
Direct debt (outstanding at year-end)	857	857	1,092	1,166	1,232	2,712	2,842	1,392	3,022	3,252
Direct debt (% of operating revenues)	33.5	32.3	40.1	49.9	53.1	112.6	115.1	56.2	118.2	124.6
Tax-supported debt (% of consolidated operating revenues)	33.5	32.3	40.1	49.9	53.1	112.6	115.1	56.2	118.2	124.6
Interest (% of operating revenues)	1.4	1.8	1.4	1.4	1.4	1.9	1.9	N/A	N/A	N/A
Debt service (% of operating revenues)	5.3	9.3	8.8	5.7	9.2	8.2	5.9	7.3	5.9	3.8

*Base case reflects Standard & Poor's expectations of the most likely scenario. §Downside case represents some but not all aspects of Standard & Poor's scenarios that could be consistent with a downgrade. Note: Downside not adjusted for non-cash items. CHF--Swiss franc. N/A--Not applicable. N.M.--Not meaningful.

Key Sovereign Statistics

For sovereign statistics, please see "Sovereign Risk Indicators," published July 1, 2013.

Related Criteria And Research

- International Local And Regional Governments Default And Transition Study: 2012 Saw Defaults Spike, March 28, 2013
- Principles Of Credit Ratings, Feb. 16, 2011
- Methodology For Rating International Local And Regional Governments, Sept. 20, 2010
- Methodology And Assumptions For Analyzing The Liquidity Of Non-U.S. Local And Regional Governments And Related Entities And For Rating Their Commercial Paper Programs, Oct. 15, 2009
- Public Finance System Overview: Swiss Cantons, July 30, 2009

In accordance with our relevant policies and procedures, the Rating Committee was composed of analysts that are qualified to vote in the committee, with sufficient experience to convey the appropriate level of knowledge and understanding of the methodology applicable (see 'Related Criteria And Research'). At the onset of the committee, the chair confirmed that the

information provided to the Rating Committee by the primary analyst had been distributed in a timely manner and was sufficient for Committee members to make an informed decision.

After the primary analyst gave opening remarks and explained the recommendation, the Committee discussed key rating factors and critical issues in accordance with the relevant criteria. Qualitative and quantitative risk factors were considered and discussed, looking at track-record and forecasts. The chair ensured every voting member was given the opportunity to articulate his/her opinion. The chair or designee reviewed the draft report to ensure consistency with the Committee decision. The views and the decision of the rating committee are summarized in the above rationale and outlook.

Ratings List

Ratings Affirmed

Basel-Country (Canton of)

Issuer Credit Rating	AAA/Negative/A-1+
Senior Unsecured	AAA

Additional Contact:

International Public Finance Ratings Europe; PublicFinanceEurope@standardandpoors.com

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